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UNCLAS SECTION 01 OF 02 TAIPEI 002868

SIPDIS

STATE PLEASE PASS AIT/W AND USTR

STATE FOR EAP/RSP/TC, EAP/EP AND EB/IFD/OMA

USTR FOR Audrey Winter and Tim Wineland

USDOC FOR 4420/USFCS/OCEA/EAP/LDROKER

USDOC FOR 3132/USFCS/OIO/EAP/ADAVENPORT

TREASURY FOR OASIA/LMOGHDATE

TREASURY PLEASE PASS TO OCC/AMCMAHON

TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN

E.O. 12958: N/A

TAGS: [EINV](#) [EFIN](#) [ECON](#) [PINR](#) [TW](#)

SUBJECT: Oil and Interest Rates Weaken Taiwan Dollar

¶11. Summary. The New Taiwan dollar (NTD), along with other East Asian currencies, depreciated significantly against the US dollar (USD) June 29. Analysts blame high oil prices and the market's expectation of higher US benchmark interest rates. There are probably also seasonal factors affecting the exchange rate. There was no apparent sign of capital outflow as foreign portfolio investors continued to post net stock purchases. End Summary.

NTD and Other Major Asian Currencies Weaken

¶12. On Taiwan's foreign exchange (FX) market, the NTD lost 17.6 NT cents or 0.55% to close June 29 at a new low of NT\$31.61 per USD in the past two months and ten days. Other major Asian currencies also fell against the US dollar. On the morning of June 29, the Japanese yen dropped to an eight-month low of 110.65 per USD in New York. In Seoul, the Korean won declined to a four-month low of 1,026.3 per USD.

Primary Culprit: Higher Oil Prices

¶13. With international oil prices rising to nearly US\$61 per barrel on June 27, businesses and analysts in Taiwan view high oil prices as a significant challenge for export-oriented and energy-thirsty East Asian economies. Subsequent declines in oil prices to US\$58.25 on June 28 and further to US\$57.62 the morning of June 29 did not relieve pressure on the NTD and other Asian currencies. USD exchange rates firmed up as the record high oil prices seemed to indicate that high oil is here to stay for some time.

Interest Rate Gap Expands Between US and Taiwan

¶14. Another major cause for a weak NTD was FX market observers' strong expectations that the U.S. Federal Reserve Board of Governors (FED) would raise interest rates at its June 30 board meeting and that Taiwan would follow suit. These expectations came true as the FED increased its benchmark rate by 25 basis points on June 30 and Taiwan's Central Bank of China (CBC) raised its benchmark rate by 12.5 basis points. As of July 1, benchmark interest rates in Taiwan are 1.25 percentage points lower than in the United States.

Seasonal Factor: Settlement of Import Accounts

¶15. There are also seasonal factors at work. FX traders attribute part of the NTD depreciation to business firms' obligation to settle their import accounts prior to the end of Q2. US dollars bought by importers via foreign banks in Taiwan on June 29 were estimated at US\$600 million or one-third of total FX trading volume that day.

Foreign Capital Remains in Taiwan

¶16. Despite the depreciation, there is no apparent sign of capital outflow. Foreign portfolio investors posted net stock purchases on June 29, and cumulative net stock purchases in June posted a new monthly high of NT\$131.3 billion (US\$4.15 billion at an exchange rate of NT\$31.6 per USD) as of June 29. However, their daily net purchases shrank to NT\$2.5 billion (US\$80 million) on June 28 and NT\$1.16 billion (US\$36 million) on June 29 down from NT\$9.2 billion or US\$292 million on June 27.

PAAL